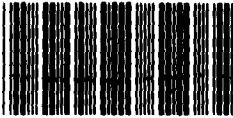


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STATEMENT OF  
ELMER B. STAATS, CHAIRMAN  
COST ACCOUNTING STANDARDS BOARD  
BEFORE  
THE UNITED STATES SENATE  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFIARS

I am appearing here today in the dual capacity of Chairman of the Cost Accounting Standards Board and Comptroller General of the United States in support of legislation to transfer the functions, standards, personnel, and records of the Cost Accounting Standards Board to the General Accounting Office, effective October 1, 1980.

The House Appropriations Committee in its report on the Legislative Branch Appropriations Bill, 1980, included the following recommendation with respect to the continuance of the Board as a separate agency:

"The Committee believes that the Board has contributed substantially to the development of consistency and uniformity in cost accounting and that its useful life should only be prolonged sufficiently to complete the indirect cost standards. Work on these standards commenced in early 1977 and the Committee anticipates that these will be promulgated by the end of FY 1980.

"The authorizing committees are urged to review the activity of the Board with the objective of placing continuing activity with an appropriate agency involving much less cost to the federal government." The Committee reduced the appropriation request from \$1,800,000 to \$1,300,000, and that is the amount agreed upon between the House and the Senate in the continuing resolution under which the legislative branch is funded currently.

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The Cost Accounting Standards Board was created by Public Law 91-379 and began its work in 1971. The statute mandates that the Board "promulgate cost-accounting standards designed to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and subcontractors under Federal contracts." These standards are required to be used by all relevant Federal agencies and by defense contractors and subcontractors in estimating, accumulating, and reporting costs in connection with pricing, administration and settlement of all negotiated prime contract and subcontract national defense procurements in excess of \$100,000, other than contracts or subcontracts where the price is negotiated on the basis of established catalog or market prices sold in substantial quantities to the general public, and those set by law or regulation.

The statute also requires that defense contractors and subcontractors disclose in writing their cost-accounting practices and to follow consistently these practices in pricing contract proposals and in accumulating and reporting contract performance cost data.

This statute followed a report from the Comptroller General requested by the Congress, in which the Comptroller General was asked to recommend both as to the feasibility and desirability of the development of standards applicable to negotiated defense contracts. The report was submitted to the Congress on January 19, 1970 and Congress enacted Public Law 91-379, August 15, 1970.

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In furtherance of its responsibilities the Board has promulgated seventeen comprehensive cost accounting standards dealing with specific cost accounting subjects. A list of these Standards is attached. (Appendix A) The Board has also promulgated two detailed Disclosure Statements, one for contractors generally and another tailored to the unique accounting of colleges and universities. A total of almost 1800 Disclosure Statements has been filed. Rules and regulations implementing both the Standards and disclosure requirements have also been promulgated.

In addition to the seventeen Standards already issued three more have been proposed for promulgation by the Board. These deal with indirect cost allocation. When public comments on these proposals have been received and evaluated, the Board will make whatever adjustments are needed to bring the proposals to the point where they can be promulgated as operating Standards. This is expected to be accomplished before the proposed transfer to the General Accounting Office occurs.

These three Standards will bring the total number of Standards dealing with specific accounting topics to twenty. This score of Standards will cover the accounting for the bulk of costs which are allocated to Government contracts. The remaining costs involve various accounting issues. Among them are the following which are currently under study.

1. Cost of Money as an Element of the Cost of Assets Under Construction
2. Capitalization Criterion
3. Gains from Disposition of Capitalized Assets
4. Selling and Marketing Costs
5. Product Development Costs
6. Joint Product Costs

A brief summary of each of these issues is appended to this Statement.

(Appendix B)

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Looking back over the life of the Cost Accounting Standards Board, it is apparent that it has contributed significantly to the development of accounting standards essential to the efficient, effective administration of Government contracts. When the Board began its work, the field of contract cost accounting was characterized by highly variable practices. Not only did various contractors have radically different practices, individual contractors applied different practices to different contracts. Efforts to determine costs uniformly and consistently on individual government contracts and proposals were frequently frustrated. The Standards promulgated by the Board have provided a sound basis for overcoming these problems. By narrowing the cost accounting options which are available and by providing for disclosure of cost accounting practices, the Board has provided a mechanism by which both the Government and its contractors can enter into contracts and have some sense of certainty as to how various costs will be treated during the life of a contract.

I have been especially pleased to have had the assistance of able Board members who have worked diligently and cooperatively in carrying out the Board's statutory mandate. The Board has also had a very capable staff headed by an executive secretary with long experience in the field of governmental accounting and auditing. However, I believe that the principal ingredient in the Board's success has been its ability to operate with great independence and because it could make its judgments on proper allocation and accounting techniques on purely objective grounds. Decisions

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could be made before the fact -- in advance of either the Government or the contractor having a vested interest because of the impact of the Standard on any particular procurement. It is particularly vital to retain this capacity now that the safeguards of the Renegotiation Board no longer exist. While that Board was operating the Government had the assurance that any contracts made under the pressure of urgent procurement requirements would be reviewed to eliminate excessive profits. As noted by a number of witnesses testifying in 1975 on the Renegotiation Board during hearings before the Subcommittee on General Oversight and Renegotiation of this Committee, the development of Cost Accounting Standards tended to make this after-the-fact protection unnecessary. Now that such protection does not exist, the need for objective before-the-fact decisions of the type that can be made by the Cost Accounting Standards Board is even greater than it has been.

In the future the Board will issue new Standards as needed and assure that the Standards, Disclosure Statement and implementing regulations developed by the Board are interpreted correctly and operate effectively to fulfill the objectives set forth in Public Law 91-379. Basically this means that organization will:

(1) Examine into whether contracting agencies and contractors continue to use the material developed by the Cost Accounting Standards Board to produce optimum benefits to both. This will necessitate observation of the activities of the agencies and contractors as they apply Standards. The Board has already established a program to review the way in which existing Standards are being applied. (Additional information on this program is contained in Appendix B.)

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(2) Monitor new Disclosure Statements as well as revisions needed to update Statements already on file and revise and clarify Disclosure requirements as needed.

(3) Amend, interpret and administer Cost Accounting Standards as needed to keep the Standards properly operating in the dynamic words of procurement and accounting. At the present time, the Board's staff is reviewing several Standards to determine whether current circumstances warrant their revision. New situations and requirements are bound to test various provisions of the Board's promulgations. An organization which is independent of the day-to-day procurement pressures will be best able to meet these tests.

(4) Continuously evaluate the operation and impact of promulgated standards, keeping in mind the statutory mandate that the Board "take into account the probable costs of implementation compared to the probable benefits." Simplification and reduction of administrative costs of standards implementation should also be an important objective.

The proposal to integrate the Cost Accounting Standards Board with the General Accounting Office will assure the type of independence that I believe is essential to the continued effectiveness of Standards. Placing the Cost Accounting Standards Board responsibilities in an executive branch agency raises a serious question as to whether such an agency could be sufficiently independent. By contrast the General Accounting Office is by law independent and has the benefit of having viewed the procurement process from that vantage point. Its historical independent role with respect to the procurement functions seems ideally suited to enabling it to assume the future responsibilities for cost accounting standards matters.

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Perhaps of equal significance is the fact that the future responsibilities concerning cost accounting standards are very similar to other responsibilities that the Comptroller General has had since enactment of the Accounting and Auditing Act of 1950. Under that Act the Comptroller General was directed to prescribe the principles, standards and related requirements for accounting to be observed by each executive agency. In fulfilling these responsibilities for over a quarter of a century, the Comptroller General has developed a broad base of experience in developing accounting principles. The expertise developed in this area will be of great value in carrying on the work of the Cost Accounting Standards Board. Because of the substantial advances made by both the Board and the Comptroller General in establishing principles and Standards, they will complement each other very well.

The Comptroller General also is required to approve executive agencies' accounting systems under the Law. This activity requires the review and approval of practices in the Government agencies which calls for a relatively direct involvement in the agencies' accounting systems. This type of involvement would not occur with respect to contractors' accounting systems under the proposed legislation. Contractor's accounting systems would not be subject to approval by the Comptroller General. Reviews would be made only to determine the manner in which Standards are interpreted and applied by both the Government and the contractors. Whenever a review indicated that a particular Standard was not achieving the objectives intended to be realized when it was promulgated, the Comptroller General would be responsible for acting to correct the situation.

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The similarities between the ongoing responsibilities of the General Accounting Office and those that will have to be fulfilled in the future administration of Cost Accounting Standards also mean that by assigning the Cost Accounting Standards function to the Comptroller General, each activity will have an opportunity to make significant contributions to the success of the other. The General Accounting Office is involved generally in reviewing the ways in which Federal agencies and Federal contractors comply with Government laws and regulations. Review of the use of Cost Accounting Standards would be a natural addition to this function. The Cost Accounting Standards Board for its part has a comprehensive background of accounting experience and knowledge upon which its cost accounting standards have been built. This experience and knowledge would be of significant value in the General Accounting Office's work with agency accounting systems and in working with the Congress on various matters involving accounting and audit issues.

The Board has made substantial efforts to keep its staff small in number. In recognition of its small staff and budget, the Board has avoided establishing a complex of administrative offices. Instead it has been lodged in the General Accounting Office building and has used various resources of the General Accounting Office, on a reimburseable basis, including use of the General Accounting Office's personnel and travel services and other support services. For most purposes the Cost Accounting Standards Board has adopted operating rules and regulations similar to those of the General Accounting Office. As a consequence of this mode of operation, the transfer of the Cost Accounting Standards Board to the General Accounting Office as proposed could be accomplished at virtually no cost and without materially



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disrupting the activities of either organization. This means that the transfer of the Cost Accounting Standards Board to the General Accounting Office would be both efficient and economical.

When the proposals which ultimately led to Public Law 91-379 were being considered in 1969 and 1970, one proposal was that the Comptroller General be assigned the responsibility for the promulgation of Standards. At that time I recommended that the responsibility be assigned to an independent Board. I noted that if such a Board were established, the General Accounting Office would exercise a legislative oversight function and would give the Board whatever assistance it could from a technical point of view. In addition I observed that it would be the job of the General Accounting Office to see that the will of Congress is carried out.

The recommendation at that time for a separate Board constituted a recognition of the unique, highly specialized work that would be required to bring cost accounting standards into being. Ordinarily such a task will be more effectively accomplished when the energy of the organization is sharply focused on a single objective without the distraction of other responsibilities. The success of the Cost Accounting Standards Board in producing comprehensive standards, in establishing disclosure requirements and in developing implementing regulations is attributable largely to the fact that it has worked in this kind of environment. The needs now have shifted so that the oversight functions necessary to assure that the will of Congress continues to be fulfilled are as important as the need to continue the development, interpretation and revision of Standards

and Disclosure Requirements. Because of this shift, I believe it is now appropriate to transfer the functions and responsibilities of the Cost Accounting Standards Board to the General Accounting Office.

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## **APPENDIX A**

- CAS 401 - Consistency in Estimating, Accumulating and Reporting Costs**
- CAS 402 - Consistency in Allocating Costs Incurred for the Same Purpose**
- CAS 403 - Allocation of Home Office Expenses to Segments**
- CAS 404 - Capitalization of Tangible Assets**
- CAS 405 - Accounting for Unallowable Costs**
- CAS 406 - Cost Accounting Period**
- CAS 407 - Use of Standard Costs for Direct Material and Direct Labor**
- CAS 408 - Accounting for Costs of Compensated Personal Absence**
- CAS 409 - Depreciation of Tangible Capital Assets**
- CAS 410 - Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives**
- CAS 411 - Accounting for Acquisition Costs of Material**
- CAS 412 - Composition and Measurement of Pension Cost**
- CAS 413 - Adjustment and Allocation of Pension Cost**
- CAS 414 - Cost of Money as an Element of the Cost of Facilities Capital**
- CAS 415 - Accounting for the Cost of Deferred Compensation**
- CAS 416 - Accounting for Insurance Costs**
- CAS 420 - Accounting for Independent Research and Development Costs and Bid and Proposal Costs**

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1. Cost of Money as an Element of the Cost of Assets Under Construction

The project examines the merits of extending the cost of money concept enunciated in CAS 414 to assets under construction. A similar project dealing with capitalization of interest is currently on the agenda of the Financial Accounting Standards Board. In order to avoid duplication of effort and to maximize consistency with FASB Statements, the Cost Accounting Standards Board deferred its work on this project until the Financial Accounting Standards Board had developed its subject more fully. An FASB Statement is now anticipated before the end of 1979 and the project has been resumed by the Cost Accounting Standards Board.

2. Capitalization Criterion

Cost Accounting Standard 404, issued in 1973, requires that a contractor have a written capitalization policy which includes a capital asset cost criterion which may not exceed \$500. Prices generally have gone up since 1973, and it is possible that the Standard should be revised to allow a higher cost criterion. Many contractors will adopt the highest value allowed in order to charge acquisition costs currently rather than to show investments and depreciation costs. In 1978 the Board approved a study to consider a change in the criterion.

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3. Gains from Disposition of Capitalized Assets

This project is to examine the need for amendment to Cost Accounting Standard 409, "Depreciation of Tangible Capital Assets," regarding the treatment of gains from disposition of fixed assets. CAS 409 limits Government sharing in gains to the amount of depreciation previously charged. The Board established the limitation because it recognized that gains in

excess of depreciation taken resulted from asset value changes and not errors in depreciation estimates.

Cost Accounting Standard 414, "Cost of Money as an Element of the Cost of Facilities Capital," was established to reimburse contractors for the "real" cost of carrying assets as well as an amount for expected changes in the purchasing power of amounts invested in assets. Since the promulgation of CAS 414, the Board is reevaluating the appropriateness of the limitation as to recognition of gains from the disposition of fixed assets.

#### 4. Selling and Marketing Costs

Selling and marketing costs are a significant element of the cost of a contractor's operations. They have been the source of many controversies and disputes as to the definition of the costs and how such costs are allocated among Government and commercial contracts.

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#### 5. Product Development Costs

In the research performed on the Standard 420 dealing with IR&D and B&P costs product development costs continually surfaced as a significant accounting problem. Most commentators said that it should be considered as a separate cost to be accounted for under criteria different from those governing IR&D. Because these costs have been the subject of much controversy in connection with the Government's participation in contractors' technical programs it appears that guidance is needed for allocation of these to U.S. Government contracts. A Standard on this subject would set forth criteria for the accounting composition of product development costs and would specify criteria to be used in allocating these costs to covered contracts in future periods.

## **6. Joint Product Costs**

There is no single cost accounting method of allocating costs to different products that are produced by the same process, commonly called joint products. An example of the problem is how to allocate the cost of a barrel of crude oil to the various products of a refinery. The Department of Defense is a major customer for joint products such as petroleum. DOD attempts to purchase petroleum products on a competitive basis but, in times of shortages, suppliers may not offer sufficient quantities to meet DOD needs. If there are no competitive quotations or suitable market prices, contracts for fuel supplies must be negotiated on the basis of cost and pricing data. In these circumstances it may become necessary to base contract prices on costs. In the absence of a Standard on allocation of joint product costs, it would be difficult, if not impossible to reach agreement on joint product costs allowable to a particular contract.

## **7. Standards in Operation**

The Board has also established a continuing project to review the effects of Standards which have been promulgated. We have met with representatives of both Government and contractors to explore their experiences under Standards. These reviews should disclose any troublesome areas which may warrant study to determine if the Standards can be improved. This may result in amendments, interpretations, new projects or other actions which will further hone the Cost Accounting Standards, Disclosure Statement and their related rules and regulations.

One thing that the review has focused attention on is the use of subjective tests in various Standards. These tests arise out of terms such as "consistent," "same purpose," "like circumstances," "minimize, to the extent practical" and "properly allocable." Successful use of such criteria, of course, depends upon reasonable decisions achieved through the process of negotiation between the contracting parties. Nonetheless it is possible that as the review process goes on we may find that additional action by the Board may facilitate resolution of questions in these areas. In other cases the review suggests that additional action by the Board may be warranted primarily to clarify the way in which a Standard is intended to operate.

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